STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

MidAmerican Energy Company	:	
	:	**Docket No. 14-0066**
Proposed general rate increase for electric service.	:	
	:	

REPLY BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

JESSICA L. CARDONI
MATTHEW L. HARVEY
Office of General Counsel
Illinois Commerce Commission
160 North LaSalle Street, Suite C-800
Chicago, IL 60601
Phone: (312) 793-2877
Fax: (312) 793-1556
jcardoni@icc.illinois.gov
mharvey@icc.illinois.gov

Counsel for the Staff of the Illinois Commerce Commission

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Staff of the Illinois Commerce Commission ("Staff"), by and through its counsel, pursuant to the direction of the Administrative Law Judge ("ALJ") and Section 200.830 of the Illinois Administrative Code (83 Ill. Adm. Code 200.830), respectfully submits this Reply Brief on Exceptions in the above-captioned matter.

I. INTRODUCTION

MidAmerican Energy Company ("MEC," "MidAmerican" or the "Company") submitted its tariffs, testimony, and Supplemental Part 285 Filing application for a general rate increase for electric service on December 16, 2013. The tariffs were suspended by the Illinois Commerce Commission ("ICC" or "Commission") on January 23, 2014. The United States Department of Defense and all other Federal Executive Agencies ("DoD/FEA" or "DoD") and Deere & Company ("Deere") intervened (collectively, "Intervenors") in the proceeding. Staff, DoD, and Deere filed their Direct Testimony on April 9, 2014. On May 7, 2014, the Commission resuspended the tariffs and the Company filed its Rebuttal Testimony. Staff and Intervenors filed their respective Rebuttal Testimonies on June 4, 2014, and MEC's Surrebuttal Testimony was filed on June 25, 2014. On June 24, 2014, an evidentiary hearing was held and the record was subsequently marked Heard and Taken. Initial Briefs were filed July 22, 2014. Reply Briefs were filed on August 7, 2014.

On September 4, 2014, the ALJ served a Proposed Order ("ALJPO") on the parties. The parties filed Briefs on Exception ("BOEs") on September 25, 2014. This Reply to Exceptions responds to several parties' BOEs. Staff does not respond to all Exceptions provided by all parties. Instead, Staff stands on its previously-taken positions on those issues.

II. REPLIES TO EXCEPTIONS

A. Pension Asset [IV.B.2.]

The ALJ appropriately recognized that the Company has offered no new credible arguments which would cause the Commission to reconsider this issue, based on the record herein, or decide the issue differently than other cases with the same facts. The Company's Exception No. 2 relating to inclusion of its pension asset in rate base should be rejected. (MEC BOE, 3-5.)

The Company takes exception to the ALJPO by arguing that the ALJPO relies on past Commission orders and is not based on the record that is distinguishable from past Commission cases. (MEC BOE, 3.) The record reflects that the test year contains no pension contribution, much less one made by externally generated funds. (Staff IB, 10; Staff RB, 7-8.) MEC also proposes alternative language that its position is good public policy to encourage utilities to re-invest earnings in the utility business. (MEC BOE Appendix A, 12.) Staff's position will not affect the funding policy of MEC, as MEC also expects there not to be any employer contributions for 2014, and the Company is receiving the full amount of actuarially determined pension expense in the revenue requirement. (Staff Ex. 4.0, 10.)

The Company erroneously concludes from N.Y. Bd. of Pub Util. Comm'rs v. New York Telephone Co., 271 U.S. 23, 46 S.Ct. 363, 70 L.Ed. 808 (1926) that there is no legal basis for treating earnings as ratepayer-supplied funds. (MEC BOE, 3-5, Appendix A, 12.) The Commission has previously considered this cite to an eighty-seven year old case, did not find it persuasive, and should do so again here. As Staff pointed out in its reply brief, the case cited by the Company, New York Board of Public Utility Commissioners*,* is essentially a retroactive ratemaking case. Staff is aware of the issue of retroactive ratemaking as well as Illinois case law on the issue. (*See*, Mandel Brothers, Inc. v. Illinois Commerce Comm'n, 2 Ill. 2d 205, 210 (1954) and a number of subsequent decisions (Citizens Utilities Co. v. Illinois Commerce Comm'n, 124 Ill. 2d 195, 206-211 (1988)). The Company has not argued that Staff's position is retroactive ratemaking, which it is not; therefore the eighty-seven year old case is not relevant to the issue in this case. The Company is seeking to collect monies from ratepayers and then charge those ratepayers with a return on investment of those monies. What is relevant, which the Company has not disputed, is that under Illinois law for ratemaking purposes a public utility may not receive a return on investment from ratepayers for ratepayer-supplied funds. (City of Alton v. Illinois Commerce Comm'n*,* 19 Ill. 2d 76, 85-6 and 91 (1960); DuPage Utility Co. v. Illinois Commerce Comm'n, 47 Ill. 2d 550, 554 and 558 (1971); and Central Illinois Light Co. v. Illinois Commerce Comm'n, 252 Ill. App. 3d 577, 583-3 (3rd Dist., 1993). *See also* Business and Professional People for the Public Interest v. Illinois Commerce Comm'n ("BPI II")*,* 146 Ill. 2d 175, 258 (1991)). The

Company stated that the source of funds for the test year pension contributions was "general corporate funds similar to the settlement of most other commercial obligations" and that "no financing or other acquisition of funds was made specifically in contemplation of the funding." (Staff Ex. 4.0, 4.)

The Commission has consistently rejected the attempts of other utilities to receive a return on ratepayer-supplied funds and should do so again here. (Central Illinois Light Co. d/b/a AmerenCILCO, et al., Order, Docket Nos. 06-0070, 06-0071, and 06-0072, (cons.), November 21, 2006, pp. 27-28; Northern Illinois Gas Company d/b/a Nicor Gas Company, Order, Docket No. 04-0779, September 20, 2005, pp. 22-23; Northern Illinois Gas Co. ("Nigas"), Order, Docket No. 95-0219, April 3, 1996, pp. 9-10, 1996 Ill. PUC LEXIS 204, *19-*23, *affd. sub nom*. Nigas, et al. v. Illinois Commerce Comm'n, Order of June 23, 1997, Appeal Nos. 3-96-0473, etc. (cons.); and GTE North Inc., Order, Docket Nos. 93-0301 and 94-0041 (cons.), October 11, 1994, pp. 8-13, 1994 Ill. PUC LEXIS 436, *16-*26, *affd. sub nom.* Citizens Utility Board, et al. v. Illinois Commerce Comm'n, Order of July 12, 1995, Appellate Court Docket Nos. 4-94-1103, 4-94-1104, and 4-94-1122 (cons.), *cert den*. December 6, 1995, Sup. Ct. Docket No. 79931, Petition of GTE North. *See also* Citizens Utility Board v. Illinois Commerce Comm'n, 166 Ill. 2d 111, 132 (1995) [Commission is unauthorized to depart drastically from practices established in earlier orders] and Mississippi River Fuel Corp. v. Illinois Commerce Comm'n, 1 Ill. 2d 509, 514 (1953) [long-term consistent actions by the Commission can constitute a binding statutory construction]).

MEC argues its alternative treatment affords symmetrical treatment to ratepayers and shareholders. (MEC BOE, 5.) In reality, in exchange for ratepayers to not be charged a return for the Company's use of the ratepayers' own funds, ratepayers would forfeit the reduced lowered pension expense that these funds caused. (Staff Ex. 13.0, 6.) Despite the Company's claim, this is neither just nor reasonable.

Accordingly, the Commission should accept the ALJPO's conclusion adopting Staff's proposal to remove the pension asset from the Company's rate base. Moreover, the Company has presented no evidence in the instant proceeding that would warrant a different conclusion from past Commission orders.

B. PIP Incentive Compensation [IV.C.1.]

The Commission should reject the MEC arguments regarding the recovery of PIP incentive compensation expense and affirm the ALJPO's conclusion to disallow 100% of MEC's PIP incentive compensation on the grounds that there is insufficient evidence to determine what portions of the incentive compensation plan costs may be recovered.

Staff appreciates and understands that the MEC PIP incentive compensation plan includes some goals which provide tangible benefits to ratepayers. The ALJPO also recognizes these benefits. (ALJPO, 22.) However, MEC's argument regarding those benefits, regarding compensation structure and PIP payout consistency, and its argument that no goal acts as a financial performance trigger do not remedy or excuse the remaining facts at issue. As explained in Staff's IB and RB, the PIP incentive compensation costs are: (1) subjective or discretionary in nature; (2) based partially on the financial performance of the Company; (3) based on goals that have no direct payout percentages assigned; and (4) based on various goals which are not associated with Illinois electric jurisdictional utility service. (Staff IB, 19-25; Staff RB, 10-17.) Further, the impact that the achievement of or failure to achieve each of the overall company goals and individual employee goals has on the final PIP incentive compensation costs is unknown. (Staff Ex. 12.0, 5.) Due to these factors, the degree to which PIP incentive compensation costs are associated with specific dollar savings or other tangible benefits for ratepayers, or associated with Illinois electric jurisdictional utility service, cannot be determined. Id. Thus, PIP incentive compensation costs and associated payroll tax and pension costs must be removed from the MidAmerican revenue requirement.[1]

As discussed previously in Staff's briefs, the Commission has been clear regarding the need for the assignment of direct payout percentages/weightings to incentive compensation goals. (Staff IB, 21; Staff RB, 12-15.) In the absence of transparent assignments of direct payout percentages/weightings, it is not possible for the Commission to determine what portion of an award is related to a utility's operational performance and what weights were given to metrics of a non-allowable financial or non-jurisdictional nature. (Staff Ex. 12.0, 10-11.) The Commission has been equally clear that the burden lies on the utility to demonstrate what portion of incentive compensation awards are sufficiently related to operational performance to justify inclusion in rates. (Staff IB, 21; Staff RB, 12-15.) These necessities are set forth most recently in the Commission's disallowance of a utility's incentive compensation costs in Docket No. 13-0318, where the Commission stated, in part:

> The LTPSAP is based on the operational and financial performance of all subsidiaries of Exelon, ComEd's parent company. These award grants depend on a management committee's subjective assessment of the performance of all Exelon subsidiaries. **There are no direct payout percentages assigned to any of the goals;**

[1] Staff's IB set forth Staff's positions on PIP incentive compensation and associated payroll tax and pension costs. Those arguments will not be repeated here. *See* Staff IB, 19-25.

> **thus, it cannot be determined what portion of an award is related to ComEd's operational performance and what weights were given to metrics related to EPS and the operations of other Exelon subsidiaries.** […] Staff's attempt to devise an approximation of the portion of LTPSAP attributable to Exelon's growth and performance (a position abandoned by Staff in its briefs) does not suffice when **ComEd has not met its burden to demonstrate what portion of these executive incentive compensation awards are sufficiently related to ComEd's operational performance to justify inclusion in rates**.

Commonwealth Edison Co., Order Docket No. 13-0318, 44-45 (December 18, 2013) (emphasis added).

The Company has failed to meet its burden to demonstrate what portion of PIP incentive compensation is sufficiently related to operational performance to justify inclusion in rates. MEC could have provided evidence of how each of its 39 PIP incentive compensation goals are weighted in determining the overall PIP incentive compensation payout, but it did not do so. (Staff Ex. 12.0, 4-5.) MEC could have also proposed to exclude portions of its PIP incentive compensation costs that the Company itself acknowledges are associated with non-allowable financial metrics or non-jurisdictional metrics, but again MEC did not make such a proposal. (MEC IB, 26, 39-41.) It is unreasonable to expect ratepayers to pay for incentive compensation costs for which the Company has clearly not met its burden of proof.

MEC complains that the ALJPO "incorrectly concludes at page 22 that MidAmerican 'does not appear to fully disagree' that these goals are financial performance based." (MEC BOE, 7.) MidAmerican claims "[t]he record shows that MidAmerican explained that these goals did not affect payout under the PIP. In 2012, even though the net income goal was not achieved, there was 100% payout of the PIP budget." Id. MEC errs in its argument. The testimony cited in the MEC BOE does nothing to explain whether the goals are based on financial performance. Rather, the cited testimony regards MEC's opinion about the impact on PIP incentive compensation of the financial goals in question. As seen in MEC's surrebuttal testimony on this topic, the Company did not provide any evidence that the two goals at issue were not, as Staff testified, based on the types of net income or earnings goals which the Commission has previously found to be not recoverable. (MEC Ex. MAG 3.0, 8; Staff Ex. 12.0, 7-8.)

MEC further complains that the ALJPO rejects (based on what MEC perceives as the ALJPO assumption that goals change from year to year) the late-proposed MEC alternative to allow some pro rata portion of PIP incentive compensation. (MEC BOE, 7-8.) MEC's complaints fail to acknowledge the basis for the ALJPO conclusion: "The Commission finds that **there is insufficient evidence to determine what portions of the incentive compensation plan may be recovered**." (ALJPO, 23.) (emphasis added.) Clearly, the AJPO conclusion is based on the fact that the degree to which PIP incentive compensation costs are associated with specific dollar savings or other tangible benefits for ratepayers, or associated with Illinois electric jurisdictional utility service, in the test year or in any other year, cannot be determined from the record evidence in this proceeding. MEC's late proposal that the Commission weight equally the 39 individual goals within the PIP incentive compensation plan is unsupported in the record in this proceeding. There is no evidence that such weighting is appropriate under the PIP incentive compensation plan. The ALJPO rightly rejects this proposal.

Finally, MEC makes a last-minute effort towards a partial cure to the shortcomings of its attempt to recover PIP incentive compensation expense and recommends the Commission allow recovery of 50% of the PIP incentive compensation expense to provide recognition of this expense consistent with the undisputed achievement of goals which produced tangible ratepayer benefits. (MEC BOE, 8.) MEC opines "[t]his would reflect a conservative amount of incentive compensation expense in rates. Excluding half of the total expense ensures that there will be no recovery of costs potentially associated with financial performance or non-jurisdictional matters." Id. This MEC proposal fails for the same reasons as its prior late recommendation: the evidence set forth in this proceeding does not support a decision to allow recovery of any amount of PIP incentive compensation. (Staff Ex. 12.0, 9-10.) To the contrary, the evidence shows that the PIP incentive compensation is subjective or discretionary in nature, is based partially on the financial performance of the Company, is based on goals that have no direct payout percentages assigned, and is based on various goals which are not associated with Illinois electric jurisdictional utility service. Id. For all of these reasons, the PIP incentive compensation must be disallowed and removed from the revenue requirement.

In summary, the Commission should reject the MEC arguments regarding the recovery of PIP incentive compensation expense, and affirm the ALJPO's conclusion to disallow 100% of MEC's PIP incentive compensation on the grounds that there is insufficient evidence to determine what portions of the incentive compensation plan may be recovered. The impact that the achievement of or failure to achieve each of the overall company goals and individual employee goals has on the final PIP incentive compensation costs is unknown. (Staff Ex. 12.0, 5.) Accordingly, the degree to which PIP incentive compensation costs are associated with specific dollar savings or other tangible benefits for ratepayers, or associated with Illinois electric jurisdictional utility service, cannot be determined.

C. Steam Production Maintenance Expense [IV.C.2.]

The Commission should reject the DoD/FEA arguments regarding the normalization of steam production maintenance expense in this proceeding, and affirm the ALJPO's conclusions that the proposed normalization is consistent with the Commission's traditional treatment of such costs.

Despite DoD/FEA arguments to the contrary, DoD/FEA did not demonstrate any failure of MEC to completely remove the double counted expense associated with steam production maintenance labor. As discussed in Staff's briefs and MEC's testimony on this issue, DoD/FEA's utilization of MEC total company numbers rather than Illinois jurisdictional amounts renders its analysis useless – as the revenue requirement being determined in this proceeding is based solely on MEC's Illinois jurisdictional amounts. (Staff IB, 27; MEC Ex. RRT 3.0, 6-7.) DoD/FEA's utilization of "other" production maintenance costs that are not even assigned to MEC's Illinois electric jurisdiction further exacerbates the problem with DoD/FEA's analysis, demonstrating again that the analysis is not based on the Illinois jurisdictional costs that are being used to determine the revenue requirement in this proceeding. Non-jurisdictional costs should not be used to assess the propriety of the normalization adjustment. (Staff IB, 27.) Further, the DoD/FEA analysis fails to demonstrate any remaining double counting of Illinois jurisdictional steam production maintenance labor. As such, the DoD/FEA argument should be rejected for purposes of this proceeding. The Commission should reject the DoD/FEA arguments regarding the normalization of steam production maintenance expense in this proceeding, and affirm the ALJPO's conclusions that the proposed normalization is consistent with the Commission's traditional treatment of such costs.

D. Distribution Maintenance Expense [IV.C.3.]

The Commission should reject the DoD/FEA arguments regarding the normalization of distribution maintenance expense in this proceeding, and affirm the ALJPO's conclusions that the proposed normalization is consistent with the Commission's traditional treatment of such costs.

Despite DoD/FEA arguments to the contrary, DoD/FEA did not demonstrate any failure of MEC to completely remove the double counted expense associated with Distribution Maintenance labor. As discussed in both Staff's and MEC's briefs on this issue, DoD/FEA's utilization of MEC total company numbers rather than Illinois jurisdictional amounts renders its analysis useless – as the revenue requirement being determined in this proceeding is based solely on MEC's Illinois jurisdictional amounts. (Staff IB, 28-30; MEC Ex. RRT 3.0, 6-7.) Non-jurisdictional costs should not be used to assess the propriety of the normalization adjustment. (Staff IB, 27.) Further, the DoD/FEA analysis fails to demonstrate any remaining double counting of Illinois jurisdictional distribution maintenance labor. As such, the DoD/FEA argument should be rejected for purposes of this proceeding.

E. State Income Tax Rate [V.C.4.]

MidAmerican claims that Staff did not raise the SIT issue until its rebuttal testimony, in violation of MEC's due process. (MEC BOE, 9-10.) MEC had more than adequate time to respond, however, for any of several reasons. First of all, MEC responded in its surrebuttal testimony. While MEC argues that this did not allow the Company "to include any other adjustments to revenue and expenses to allow for the proper matching as required by the Commission rules," (Id. at 10) MEC included responses to Staff's proposal in its surrebuttal. (MEC Ex. RRT 3.0, 3-4.) MEC also discussed the issue in its Initial and Reply Briefs (MEC IB, 44; MEC RB, 20), as well as its BOE. Therefore, MEC has had ample opportunity to address and argue against Staff's proposal. Certainly, if MEC believed Staff's proposal was inappropriate or procedurally flawed, it could have and should have filed a Motion to Strike Staff's rebuttal testimony. It did not, and the ALJ properly adopted Staff's recommendation.

MEC's due process rights are not violated. There is no set standard for what notice comports with due process but it is clear that a party must be given a reasonable notice and a fair opportunity to appear and defend on the merits. Bellingham Bay & British Columbia R.R. Co. v. New Whatcom, 172 U.S. 314 (1899); Summers v. Illinois Commerce Comm'n, 58 Ill App. 3d 933, 936 (4th Dist. 1978).) Each party must be afforded the "right to present evidence and argument [on its] own behalf, a right to cross examine adverse witnesses, and impartiality in rulings upon the evidence which is offered," exactly the opportunities MEC had during this docket. People ex rel. Illinois Commerce Comm'n v. Operator Commc'n, 281 Ill. App.3d 297, 302-303 (1st Dist. 1996). As stated above, MEC responded to Staff's recommendation in testimony, in briefs, and on exception. MEC certainly had the opportunity to cross-examine Ms. Jones on the topic but chose not to do so. And MEC cannot claim that the ALJPO is not impartial; the

ALJPO considered the evidence before it, and ruled accordingly. The Commission should not modify the ALJPO's finding on this issue.

Independent of this, there is the fact that the ALJ would be within her rights to make the adjustment *sua sponte*, based on the state of the law at all times relevant to this proceeding, of which she was absolutely authorized – indeed obliged - to take notice. The 2015 state income tax rates have been known and measurable since January 2011, when the Illinois Legislature passed Senate Bill 2505, which raised the state income tax rate for individuals and corporations as of January 1, 2011. 35 ILCS 5/2-201. However, rates were to revert to their pre-2011 levels as of January 1, 2015. Id. In other words, the law is clear, regardless of when or even whether Staff raised it. The Commission's decision regarding the test year income tax rate, as the ALJPO correctly found, "must [be] base[d] … on current law[,]" rather than "speculat[ion] … based on what the General Assembly may do in the future." Accordingly, the Commission should reject MEC's arguments and adopt the ALJPO's findings regarding state income tax.

F. Cost of Capital [VI.D.]

The Company separates its BOE into two parts: certain arguments are included in a document referred to as the "Brief On Exceptions," while the replacement language is just referred to as "Exceptions." In its BOE, the Company argues that its forecasted risk-free rate and risk premium analyses are appropriate and concludes, therefore, that the Commission should adopt its 10.7% cost of common equity estimate. The Company's replacement language reflects that same overall conclusion, but includes arguments and conclusions on other issues not supported in the Company's "Brief On Exceptions."

Although the appropriate proxy sample was not addressed in the Company's BOE, the proposed replacement language presented in the Company's Exceptions concludes that the Company's proxy sample should be adopted. (MEC Exceptions, 49, 52.) That replacement language, however, does not address the arguments given in the ALJPO for rejecting that sample, nor does it present any argument supporting its conclusion. Therefore, it should once again be rejected.

Likewise, the proposed replacement language presented in the Company's Exceptions regarding the DCF model should also be rejected. This, too, adopts the Company's results with no discussion in the Company's BOE and no argument supporting its conclusion. (MEC Exceptions, 50.) The issues of the DCF results and proxy sample are inextricably entwined. Both the Company and Staff utilized the Company's DCF model results. The only difference, aside from the removal of the flotation cost adjustment embedded in the Company's results, (Staff IB, 45-46) is that Staff's DCF estimate is based on a 12-company subset of the Company's 28-company sample. With the rejection of the Company's proxy sample (and flotation cost adjustment) in favor of Staff's proxy sample, the resulting DCF estimate from the Company's proxy sample must likewise be rejected in favor of Staff's DCF estimate.

Also without discussion in its BOE, the Company's Exceptions concludes that the Company's generalized, 23 basis point flotation cost adjustment should be adopted. (MEC Exceptions, 50.) This proposed language, too, should be rejected. Not only has the Company provided no support for that proposed language in its Exceptions, but that language presents improper, new argument not previously proffered. Those concerns notwithstanding, the ALJPO correctly notes that the Commission approves flotation cost adjustments only upon one of two conditions: (1) the utility anticipates issuing stock in the test year; or (2) if the utility demonstrates that costs incurred prior to the test year were not previously recovered through rates. Oddly, while the Company's replacement language includes that first condition, which is not at issue in this proceeding, it conspicuously excised the second, which very much is at issue. The Commission has repeatedly stated that "[the utility] has the burden of proof on this issue," (Commonwealth Edison Co., ICC Order Docket No. 94-0065, 94-95 (January 9, 1995)) but, as the ALJPO notes, the Company has provided nothing to demonstrate that costs incurred prior to the test year were not previously recovered through rates. Instead, the Company's replacement language only offers a vague, nonsensical attempt to rationalize the Company's unfounded proposal. Thus, its generalized flotation cost adjustment should once again be rejected.

With regard to the CAPM, the Company's Exceptions disingenuously labels the Company's own DCF-based CAPM result as "Staff's adjusted CAPM." The CAPM requires three inputs (i.e., the risk-free rate, the required rate of return on the market portfolio, and beta (Staff Ex. 6.0, 24)); however, the Company's so-called "Staff's adjusted CAPM" replaces Staff's estimates for all three inputs with the Company's estimates for those inputs.[2] Moreover, it applies that model to the Company's sample

[2] In fact, the whole discussion of "Staff's adjusted CAPM" was a pretense, as the result of that calculation was not reflected in the ROE "adopted" in the Company's Exceptions. After developing a range of results based on multiple CAPM analyses, the Company's proposed replacement language dismisses all but the highest CAPM result – the Company's DCF-based CAPM with a flotation cost adjustment – on the basis of an argument against the use of the CAPM, generally, that Staff fully refuted and the ALJPO rejected. (MEC Exceptions, 51; Staff IB, 54-56; ALJPO, 47.)

rather than Staff's sample. (MEC Exceptions, 51.) Thus, what the Company misleadingly labels as "Staff's adjusted CAPM" is actually the Company's DCF-based CAPM result, without the generalized flotation cost adjustment that has been repeatedly rejected. As noted above, the ALJPO's rejection of the Company's sample should be upheld by the Commission. Thus, the Company's CAPM results (including the so-called "Staff's adjusted CAPM"), which are a function of the underlying Company sample, must be rejected as well. The only remaining question is whether or not to adjust *any* of the inputs used in Staff's actual CAPM analysis.

For the CAPM's three inputs, Staff's actual analysis adopted the Company's required rate of return on the market and Value Line betas, but added two other betas sources and substituted an actual U.S. Treasury bond yield for the Company's forecast of the risk-free rate. (Staff IB, 46.) While the Company's BOE obviously does not take issue with Staff's estimate of the required rate of return on the market, it does dispute Staff's risk-free rate estimate. And, although the Company's BOE does not address Staff's beta estimate, the Company disputes it through the proposed language in its Exceptions.

The Company's Exceptions concludes that Staff's beta estimation methodology is biased because it typically generates lower betas than published betas. (MEC Exceptions, 51.) That proposed replacement language should be rejected. To begin with, the Company's language represents improper briefing and, thus, cannot be adopted, as it is based on alleged facts not in the evidentiary record. Contrary to the Company's assertion of "undisputed evidence in the record," the claim that Staff's beta estimation methodology typically generates lower betas than published betas was never even made, let alone established, in this proceeding. Even if that claim were supported by evidentiary evidence, its logic is flawed, as it assumes the conclusion, without foundation, that the higher betas are more accurate than the lower betas. One could just as credibly argue that the published betas are biased because they are higher than Staff's beta estimate. Regardless, this issue has been litigated numerous times, with the Commission adopting Staff's beta estimation methodology stating, "We agree that, in the same way we rely on multiple models to determine the cost equity, Staff's well-considered use of multiple beta sources is beneficial to reduce measurement error from any individual estimate." <u>North Shore Gas Co. and The Peoples Gas Light and Coke Co.</u>, ICC Order Docket Nos. 09-0166/09-0167 (Cons.), 126-127 (January 21, 2010). For these reasons, Staff's beta estimate should once again be adopted by the Commission.

In its BOE, the Company argues that its risk-free rate estimate, based on a contrived forecast, should be adopted and that Staff's estimate, based on actual current 30-year U.S. Treasury bond yields, should be rejected. (MEC BOE, 12-16.) Staff fully addressed the flaws in the Company's risk-free rate estimate and related arguments in Staff's IB and RB. (Staff IB 41, 43, 52-54; Staff RB, 25-27.) The Company's argument is confused and unfounded. To begin with, the Company excluded its CAPM results in determining its 10.7% ROE recommendation. Therefore, use of a forecasted risk-free rate does not support the adoption of the Company's ROE recommendation. In addition, the Company nonsensically criticizes *current* interest rates as not reflecting *current* market conditions and, instead, proffers *forecasted* interest rates, which by their very definition do not reflect current market conditions. The Company later criticizes current interest rates as not reflecting *future* market conditions implying, in contrast, that forecasted rates do reflect future market conditions. That implication is unfounded, as future market conditions cannot be known in advance. As to whether current actual interest rates or forecasted interest rates are better estimators of future interest rates, the record evidence shows current interest rates consistently outperforming forecasts in estimating the interest rates ultimately realized for the forecast period and that forecasts tend to be biased upward. (Staff IB, 53.) The Company has presented no evidence to the contrary. For all these reasons, and those explained in Staff's IB and RB, the Commission should uphold the ALJPO's conclusion and reject the Company's risk-free rate estimate and adopt Staff's.

Further, the Company's BOE argues that the ALJPO's rejection of the Company's risk premium analysis should be reversed. (MEC BOE, 16-18.) The Company's attempts to defend its risk premium analysis were fully refuted in Staff's Reply Brief, in which Staff explained the numerous fatal flaws in that analysis, the type of which have led to its repeated rejected by the Commission. (Staff RB, 27-29.) The Company offers nothing new in its BOE. Thus, the Commission should uphold the ALJPO's conclusion and once again reject the Company's risk premium analysis.

Finally, the Company's Exceptions also presents an alternative proposal for the language in the Final Order that would accept, wholesale, the Company's and Staff's DCF and CAPM analyses (including the Company's flotation cost adjustment, but not Staff's). (MEC Exceptions, 51-54.) Staff has explained, and the ALJPO correctly concurred, based on the details specific to this proceeding, that the Company's recommendations suffer from numerous critical errors that render them unacceptable, while Staff's recommendations are based on sound financial principles and should be adopted. The Commission should not be misled by generalized arguments that ignore the extensive record of this particular proceeding and fail to differentiate fatal analytical flaws from the minor imperfections inherent in cost of common equity analyses. Moreover, even the Company acknowledges that such an approach would create a bad precedent, as the Company's proposed language distances the Commission from the conclusions therein by including multiple caveats noting that the Commission does not endorse every aspect of the cost of equity estimates it would ultimately be accepting. (MEC Exceptions, 52-54.) Worse, the Company's alternative proposal would require that the Commission embrace conclusions that contravene many prior Commission rulings. Thus, the Commission should reject the Company's alternative proposed replacement language in its entirety.

III. CONCLUSION

WHEREFORE Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in their entirety consistent with the arguments set forth herein.

Respectfully submitted,

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Jessica L. Cardoni
Matthew L. Harvey

Illinois Commerce Commission
Office of General Counsel
160 North LaSalle Street, C-800
Chicago, IL 60601
(312) 793-2877
jcardoni@icc.illinois.gov
mharvey@icc.illinois.gov

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Counsel for Staff of the Illinois Commerce Commission